DOW THEORY LETTERS INC.

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36 Letters per Year—$60.00 Annually

Registered with the Securities Exchange Commission

May 2, 1969 Letter 426

THE MARKET: I have been pouring over piles of newspaper reports, market analyses, poop-sheets and investment letters until my eyes are bleary. I have never seen such a mass of groping opinions on so many important subjects. Will the franc fall, who will rule France, will the pound hold, are the Paris peace talks getting anywhere, is Nixon getting anywhere, are the anti-inflation measures getting anywhere, can anyone get anywhere reading the best inside opinions of the best men in and out of Wall Street?

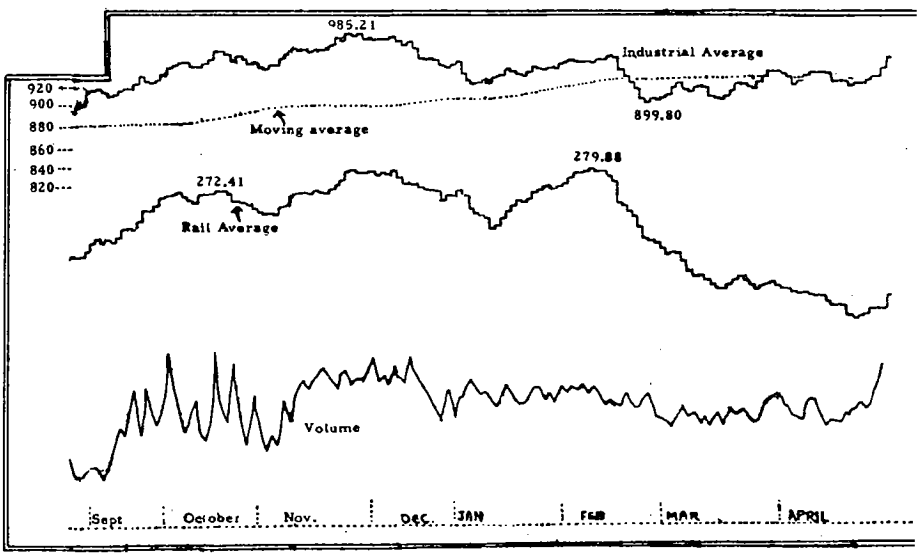
At moments like these I turn to Dow's Theory. The Theory takes little note of specific events, it takes little heed of published opinions, Presidential scoldings, Congressional rumors or Federal Reserve Board manipulations. Dow's Theory is based on the principle of tides, and like the movements of the ocean, the ripples and waves seldom effect the main tide.

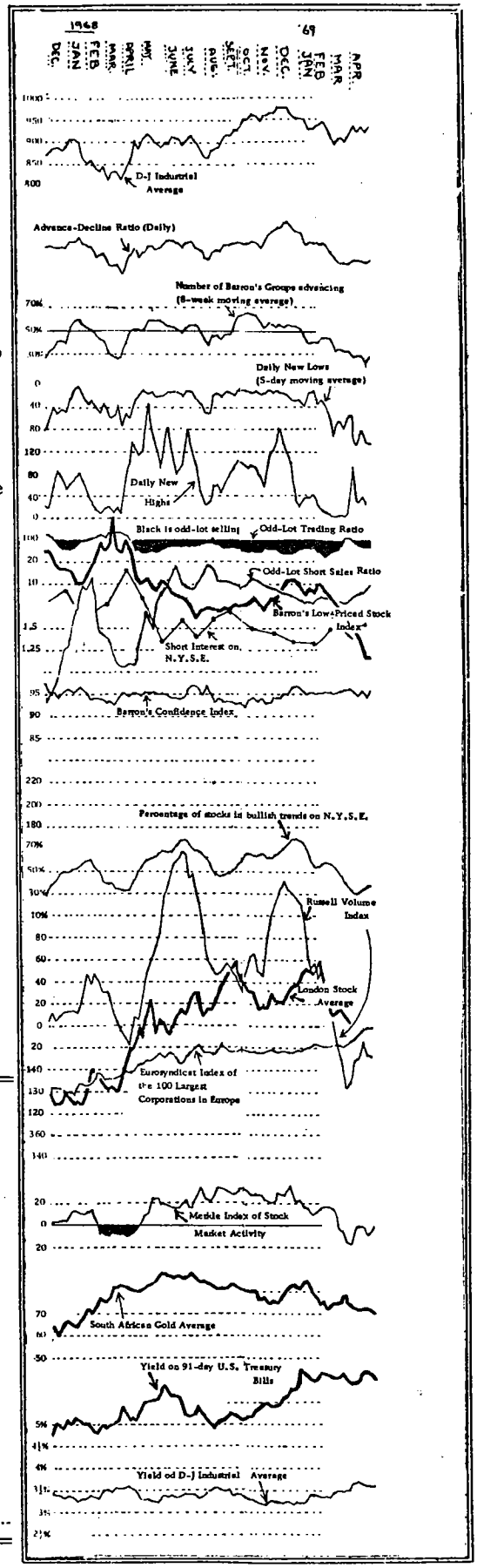
A bull market ended at 995.15 on February 9, 1966. At that point, the massive primary bull tide which had been in effect since June 13, 1949 ran out. Since the 1966 high, wave after wave has pushed upward against the main tide, but nothing has succeeded in taking the Dow Industrials above their 1966 peak.

Now, with Government analysts pouring over the latest statistical data for the slightest hint regarding the end of inflation, with bank borrowings near the billion dollar mark, with interest rates at or near the Civil War highs, with DeGaulle in retirement, the nation is mystified as to which direction the market is "supposed to go?"

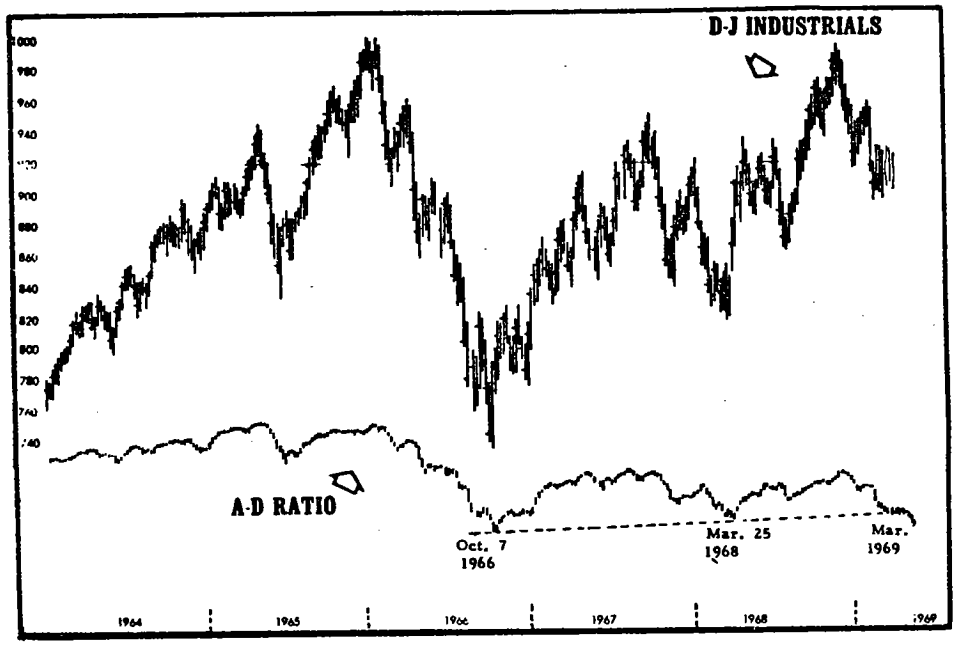
The answer, according to Dow's Theory, is that over the long term, regardless of more rallies, more hopes, more peace rumors or even peace itself, the tide is running out, and the market is heading down. The market, however, never does what it is supposed to do when it is supposed to do it. Wall Street has a maddening habit of discounting first, then moving in the opposite direction when the news comes out, then finally moving with the primary trend when there's nothing else to do.

Right now the market is relaxing following its descent from the 988.21 (Dow) high of last December 3. Much of the bad news which has emerged recently





was discounted by the December to February drop from 988.21 to 899.80. The correction or retracement now going on will wand its way sideways or upwards until it exhausts itself, but the steam in a correction (like the waves of the ocean) are never enough to completely turn the tide.



It is this tidal principle which is the hardest thing in the world to get over to investors. The tide is something which you cannot see at any given time, it is not something you can feel at any given time. They understand the primary principle best who have lived through a complete market cycle of bull to bear and back to bull market again. Unfortunately, this leaves out most of today's investors, since the last such cycle took place in the 1940's and more clearly defined in the 1930's.

For today's investor s the best course is a thorough study of the past if you have not personally lived through it. I spent a solid two years studying the Averages, from the date of their daily issuance in 1896 to the present. I know of no substitute for this type of thorough knowledge of what went before. And the study is much more valuable if one can go through the newspapers and journals of the times, noting how each movement in the market anticipated coming events, and how difficult it was to "call" the successive major tops and bottoms.

NEAR-TERM: On April 22 (see last Letter) the advance-decline ratio broke to a new 1969 low. In so doing, it also broke below its May 25, 1968 low, reaching its lowest level since the October 7 bottom (see chart). This creates a technical vacuum under the Dow. A downside confirmation by the Dow would entail a breaking of the 1968 low of 825.15. Following the April lows, a reversal took place.

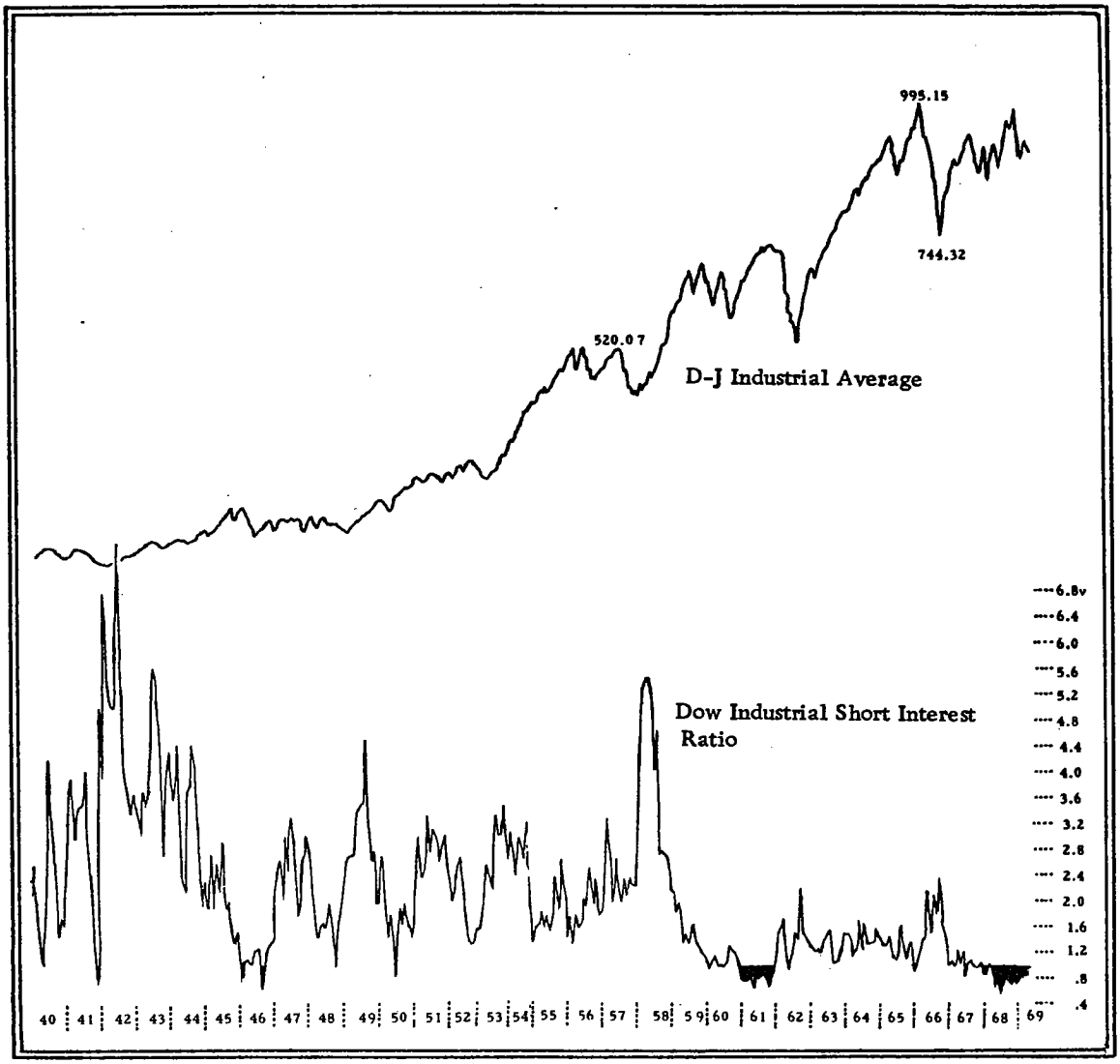
On April 29 the Industrials soared 9.02 points while rails remained unchanged. The next day, of booming volume, Industrails pushed to a new recovery high above the March 20 peak of 935.48. This sets up a series of non-confirmations with Industrials pushing to three successive peaks above the early March peak while Rails and the advance-decline ratio continue to diverge importantly. A continued lag by Rails and the A-D ratio would suggest a dangerous situation.

APRES MOI... After losing a minor referendum, DeGaulle (as is his habit) did what he said he would do. He resigned. I had always considered DeGaulle the sanest man with real power in the Western World. Other men are as sane, other men are more powerful, but no one now in office anywhere has the combination. France is now on its own sans DeGaulle. Uncertainity will rule for weeks, perhaps months.

Previously, there had always been competition between the President and the rest of his cabinet in France. DeGaulle held undisputed power. The new President of France, whoever he may be, will not have DeGaulle's power. In strife-torn, inflation-saturated France a weaker President than DeGaulle is a problem, and in these times it is a liability.

I did not think the franc would withstand devaluation with DeGaulle; there was simply too much opposition to DeGaulle's anti-inflation measures, particularly on the part of the labor unions. Without DeGaulle I do not see how the franc has a chance of holding out against ultimate devaluation.

How much of what happened in France has already been discounted by world gold prices and world markets? Probably a good deal. This discounting plus the world-wide euphoria which has reached incredible proportions could result in the markets taking less than dramatic note of DeGaulle's departure. I feel that the coming crisis will have actually to occur before the markets are shaken out of their complacency. But it seems to me that DeGaulle's departure is another step towards the coming crisis. The cry of "Wolf" has been heard over and over again since the bull market topped out in February, 1966. The crack on Wall Street may be put off until the wolf actually appears— as he will.



DOW SHORT INTEREST RATIO: This is the important new indicator which was developed by Bill Gordon of Indicator Digest. I have been keeping readers informed on this index for over a year, and the latest up-dated study is included here.

Danger signals are rendered when the Dow Short Interest (DSI) holds under 1.0 for any length of time. Such occurrences are exceedingly rare, and as seen on the chart only two such areas have appeared since 1940. The first (solid black on chart) showed itself in January, 1961, when the Dow sank below 1.0. It held below 1.0 for a period of 13 months, and this was followed by the 1962 debacle.

The second area started in January, 1968, when the DSI dropped to .85. With the single exception of March, 1968 (when the DSI rose to 1.13), this index has held under 1.0 ever since. The latest reading on the DSI is .85 for April. This means that this important indicator has been flashing a danger signal for 15 of the last 16 months, a length of time unmatched in market history.

I give particular credence to the DSI because (1) it is followed by few other analysts, and (2) it provides very infrequent signals, (3) it has no record of failure, although, of course, since 1940 there has only been one real test (the second test is now underway).

SUPER-INFLATION: While many business leaders moan that the Administration's tough measures are calculated to "over-kill" the boom, the latest statistics regarding inflation look worse than ever.

 During March the Federal Reserve Board's production index spurted at several times its February pace and now stands at a record 170.5. The Commerce Dept. announced that personal income advanced by $5.3 billion during March to a record annual rate of $726.7 billion. Commerce also reported that the nation's GNP, the total of all goods and services, jumped by a whopping $16 billion during the first quarter to bring the total GNP to an astronomical $903.4 billion.

Finally, on April 24 the Labor Dept. released the most discouraging statistic of all. During March the "cost of living" rose .8%, the biggest jump since February, 1951 (during the Korean war) and double the average monthly gain for 1968. The Labor Dept. also announced that the 1.5% rise in cost of living during the first quarter of 1969 was the biggest gain since mid-1956. Officials stated that the March jump in cost of living was no "fluke," but represented a widespread rise in almost every segment of the economy.

On the balance-of-payments front, the figures are not all in, but advance statistics indicate that after the fourth quarter, 1968 surplus of $990 million, the first quarter of 1969 will probably go way into the red with something like a $1 billion international deficit.

The conclusion is not very difficult to arrive at. The measures now being used by the Administration and its agencies to hold back inflation, the fiscal and monetary measures which are producing record interest rates and a contraction in the money supply rate, will continue.

As I read the latest statistics as outlined above, I was reminded of the warning which appeared in the April issue of the authoritative Bolton Tremblay Bank Credit Analyst: "In the very unstable environment near the top end of the long term credit cycle, present Fed action, if pursued through April-May, could trigger a financial disaster. Odds definitely favor an easing of the squeeze before then."

When that was written, the Bank Credit Analyst naturally could not know that inflationary statistics would continue to pour out of Washington. Well, they have, and as I see it there will be no easing of the monetary and fiscal measures. So, we will have to see what the month of May brings (and it would be well to remember the Bolton Tremblay warning).

In his latest report, "contrarian" Humphrey Neill notes that all booms are accompanied by the twin bogies of speculation and monetary expansion. Speculation continues at white-heat pace, today with "deals" and "gyrations" of Wall Street being witnessed day after day. "Lincoln Center is misnamed," says Neill, "Wall Street has become the center of the performing arts."

Monetary expansion, although now facing opposing forces, is still built in to this nation and economy in a massive way (see chart on corporate debt to assets ratio in this Letter). Debt is swollen on Wall Street, in the mortgage market, at the federal, state and city level as never before. All this debt must be serviced, and only a boom will allow enough income for servicing debt and the current record rates of interest. In other words, the nation has become a debt-balloon, subject to the puncture of recession.

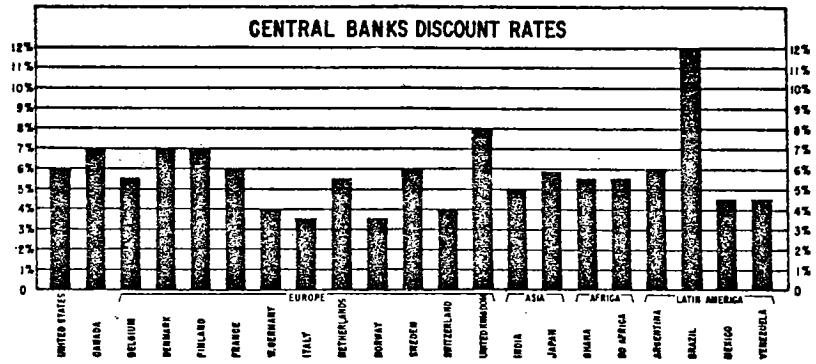
CHARTS OF THE WEEK (See Page 5): The outstanding debt of American manufacturers continues to climb, producing new lows in liquidity. As the chart shows, manufacturers' debt as a percentage of their total book value reached a new high in the first quarter. From 29% in 1949, the percentage of debt has risen higher and higher until on December 31, 1968 it reached 44%. This new high in debt as a percentage of assets has been achieved in the face of the highest interest rate in 100 years.

What this means is that manufacturers are anticipating continuing inflation and continuing higher sales. They are ill prepared for either lower sales (which would shrink their income sharply) or an end to inflation (which could lower the selling price for their merchandise). No one is playing it safe or "saving for a rainy day." Why should they; it hasn't rained in a long, long time.

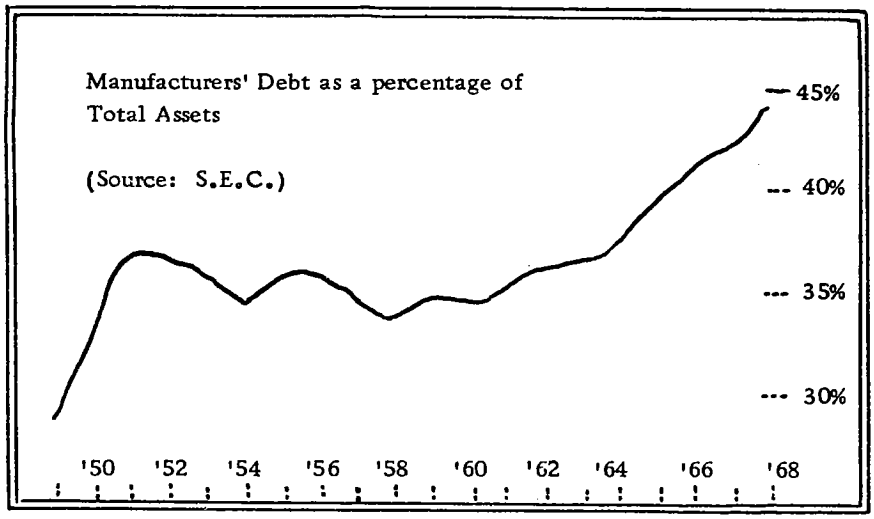
Meanwhile, the central banks throughout the world are fighting to protect their monetary positions. In recent weeks, West Germany's bank rate rose from 3 to 4%, the U.S. went from 5.5 to 6%, Denmark went from 6 to 7%, Belgium rose from 5 to 5.5% and the Netherlands boosted their bank rate from 5 to 5.5%. I have shown it all on the accompanying chart.

Fifteen of the twenty-one nations shown now have bank rates of 5% or more, and there has been nothing like this in this generation. What will lower these rates in the future? A recession or depression could build up liquidity, resulting in a world lowering of money rates. A heavy boost in the price of gold could also raise world liquidity, thus resulting in lowered bank rates. Barring these two contingencies, I do not know any other fundamental which would result in a reversal of the interest rate trend. Meanwhile, it is becoming increasingly difficult for the world to do business. even at current high rates. Something has got to give.

BRITAIN: As seen on this chart from the Investor (354 Kensington Rd., London, S.E. 11), the British stock market is now in trouble. Since the fall of 1966, the Financial Times Index has moved steadily higher, discounting inflation and ignoring all the dangers and inefficiencies which have been built into British industry. In late 1968 the FT Index halted at the 520 area, declined, then ran up to a double-top in the 520 area again during January, 1969.



A second decline occurred during the first quarter of 1969, and this time the late-1968 low was penetrated. On a simple chart reading, it would appear that the 1968 secondary low was broken and that a "bear signal" has been rendered. The reasons advanced for the recent weakness in the British market are many, but higher corporate taxes and an 8% bank rate are reason enough.



The old Wall Street adage states that the British market always tops before the American market. This has been roughly true in the past, and it could now be true again. At any rate, I am reminded of another adage which states that inflation is bullish to a point— and that inflation then becomes a bearish force on the market and the economy. We seem to have arrived at the "point," both in Britain and in America.